Module: Management
Section: Human Resources
EM-530

Introduction

Human resources management (HRM) focuses on effective personnel management. HRM involves placing and utilizing personnel in an organization's structure through selection, appraisal, compensation, and development programs. HRM is not an isolated element of management; it can be found throughout other functions such as planning, directing, organizing, and controlling. The foundation of an HRM program consists of board-approved policies. HRM policies are vital to the development and continuity of a quality staff and should relate directly to organizational needs, treat employees equitably, and be consistent with an organization's management system and mission. Additionally, these policies and procedures should address the following major elements of an HRM system:

- Planning;
- Recruiting and retention practices;
- Compliance with laws and regulations;
- Employee training and development;
- Performance evaluation;
- Compensation administration; and
- Employee benefits.

Examination Objective

Determine the effectiveness and adequacy of the institution's HRM function.

Elements of an HRM System

The HRM elements listed above are discussed in the remainder of this section. The extent to which examiners should analyze each of these areas depends on the particular circumstances of the institution being examined. For example, if previous examinations have not identified significant weaknesses in an institution’s HRM, there may be no need to conduct an in-depth review. On the other hand, if significant weaknesses were previously identified and/or major changes were made to the institution’s HRM, further review would be prudent.

Planning

The human resources function must be proactively managed to ensure the institution's long-term success. Institutions must renew human capital and steadily upgrade human services in order to maintain efficiency and performance. To accomplish this requires prudent HRM planning, including forecasting and succession plans.

Forecasting should be examined in the framework of the organization's total planning function. Since positions are filled for the present and future, a sound HRM program must address future requirements. The forecast must consider the areas in which the institution will grow or decline and how such changes will affect staffing. HRM forecasting, then, must:

- Relate to the long-range planning function;
- Identify future staffing needs created by turnover and changes to the organization's mission and function; and

- Effectively use performance appraisal and employee development to meet future needs.

Succession plans should address levels ranging from middle management to the chief executive officer (CEO). This plan should be in writing and include strategies for preparing candidates for succession.

Recruiting and Retention Practices

Effective recruiting and retention practices are essential for successful business operations. Recruiting involves matching individual skills, abilities, and interests with the characteristics of a particular job. This may be accomplished through outside recruitment or reassignment of existing personnel. Regardless of the method chosen, it is a costly and time-consuming process. Consequently, each person hired is a significant investment from which an organization must attempt to recognize a return. To do so, the institution should have an employment program, which, at a minimum, includes the following:

- Carefully defined job qualifications;
- Validation of selection methods;
- Advertisement of vacant positions and competitive selection procedures;
- A career planning program to identify employees' potential and assist in their development; and
- A recruiting program that provides a reliable source of trainees.

Retention of employees is as important as recruitment. Constant turnover is expensive and inefficient. Organizations should concern themselves, therefore, with the well being of their employees through such programs as long-range career planning and development, counseling, mentoring programs, etc. These topics are more fully discussed below the headings *Training and Development* and *Employee Benefits* in this section.

Compliance with Laws and Regulations

NOTE: The guidance in this subsection on Affirmative Action is outdated due to changes in the regulations. Updated guidance is under development. See Attachment A for a link to the current regulations.

Employment practices and programs must comply with federal, state, and local laws and regulations, including, but not limited to, civil rights laws, the Fair Labor Standards Act (FLSA), and regulations of the Equal Employment Opportunity Commission (EEOC). The FLSA sets out the minimum wage employers must pay to each employee. The equal employment laws include the Civil Rights Acts of 1964 and 1991, the Age Discrimination in Employment Act of 1967, the Rehabilitation Act of 1973, the Equal Pay Act, and the American with Disabilities Act of 1990. The EEOC regulations, under 29 CFR 1614, requires employers to provide equal opportunity in employment for all persons; to prohibit discrimination in employment because of race, color, religion, sex, national origin, age, or handicap; and to promote the full realization of equal employment opportunity through a continuing affirmative action program.

Section 4.38 of the Farm Credit Act of 1971, as amended, (Act) on affirmative action requires System institutions with more than 20 employees to establish and maintain an affirmative action program (AAP) plan that applies the affirmative action standards otherwise applied to contractors of the Federal government. These standards are set forth in the Code of Federal Regulations issued by the Office of Federal Contract Compliance Programs under Title 41 CFR 60-2. In general, an acceptable AAP plan must include an analysis of areas where the institution is deficient in the utilization of minority groups and women. The plan also should set goals and timetables to which the institution's good faith efforts must be directed to correct deficiencies in utilizing minorities and women at all levels and in all segments of its work force (41 CFR 60-2.10).

However, because System institutions are not Government contractors, only the substantive standards set forth in Part 60-2 should serve as guidelines for the development and implementation of System AAP plans. For example, the basic components of an adequate plan should include, at a minimum, the standards set forth in CFR 60-2.13. However, 41 CFR 60-2.14, which requires affirmative action programs to be summarized and updated annually, is procedural in nature and is not applicable to System institutions. Since 41 CFR Part 60-2 only serves as guidance for System institutions, the institutions cannot be cited for a violation of 41 CFR Part 60-2. When examiners find a System institution's AAP plan deficient, they should cite a violation of section 4.38 of the Act. A copy of 41 CFR Part 60-2 issued by the Office of Federal Contract Compliance Programs is attached to provide additional examiner guidance (Attachment A).

Institutions may develop AAP plans that vary in structure and detail depending on the size and complexity of the institution. However, where an institution is unable to demonstrate its efforts, its credibility and commitment to equal employment opportunity and affirmative action may be called into question.

Examiners should keep in mind that institutions consider AAP plans to be confidential due to the statistical data regarding their own personnel as well as other sensitive employee information. As with any other institution document, safeguarding against improper disclosure is essential. It is incumbent upon the examiner to ensure the confidentiality of such material throughout the examination process.

Training and Development

The goal of training is to help employees acquire the skills needed to perform job responsibilities satisfactorily. The performance appraisal process is a principal mechanism by which training needs are identified. Once identified, an individual development plan (IDP) can be developed. Subsequently, areas of weak performance can be appropriately addressed with specific training process. Such training may include on-the-job training assignments, in-house training programs, or external training programs. Regardless of the type, management should ensure that the training provided is effective. To ensure effectiveness, management must assess the training thoroughly to determine the following:

- Is the training pertinent to the job? Employees should have the opportunity and ability to apply the training knowledge to the job situation. Management should obtain trainee reaction and evaluation of content, purpose, and usefulness of the training experience.

- Does the training actually contribute to better job performance? This requires a review of individual performance.

The career planning and development process uses many of the same techniques as training, but the focus is more long term to prepare employees for activities beyond their current job responsibilities. By developing and promoting existing employees, institutions can avoid filling future positions through outside recruitment. Like training, development relies on the performance evaluation system to identify employees with advancement potential. Additionally, it should focus on the human resources plan/forecast to assure that developmental efforts coincide with future staffing needs.

In addition to training techniques such as on-the-job training assignments and formal classroom experience, development also employs special work assignments to provide operational experience and prepare the recipient for greater responsibility.

Characteristics of a successful training and development program include:

- Link to HRM forecast;
- Periodic assessment of training needs, and employee training related to those needs;
- Performance appraisals to identify skill or knowledge deficiencies;
- Planned training through the use of IDPs; and
- Evaluation of training effectiveness and results.

Performance Evaluation

The major link between an organization's management system and its HRM system is performance evaluation. One of management's functions is to define the organization's functions and responsibilities, and allocate them to individual units and staff members. Performance evaluation is an ongoing planning and feedback mechanism that helps determine whether these functions are being performed effectively. Performance evaluation provides a means to hold employees accountable for expected results. In addition, performance evaluation provides input for the organizational planning process and may result in reorganization, relocation of functions, or realignment of responsibilities. Performance evaluation also directly influences the other elements of the HRM system. For example, it can serve as a basis for:

- Identifying employee potential as part of the forecasting and internal staffing and development processes;
- Identifying weaknesses to be addressed by training;
- Providing feedback and recognition to stimulate performance and improve employee morale;
- Providing input to managers in determining compensation increases; and
- Evaluating the effectiveness of HRM.

When examining an institution's performance evaluation program, examiners should ensure that significant performance standards are identified and consistent with the position requirements, and include special or part-time projects that are significant in scope. Ideally, performance standards should be agreed to and developed by the supervisor and employee. Performance standards and objective measurement tools need not focus on quantitative measures exclusively. They may include measures of adherence to procedures, quality, timeliness, accuracy, and cost effectiveness. In addition, some standards may reflect more than one measurement. Finally, the goals and standards must be assessed in terms of attainability. The standards agreed to should not be too demanding or too easy to accomplish.

A successful performance evaluation system generally includes a face-to-face appraisal session between supervisors and subordinates. In the appraisal session, it is important to focus on the agreed-upon goals and standards and the extent to which they were met. The comparative importance of each standard must be taken into account at the time of appraisal. Reasons for deviation from performance standards should be explored to identify causes and corrective action. Likewise, exceptional performance should be rewarded.

Corrective actions should lead to improved employee performance and might include training or retraining, closer performance monitoring, more frequent feedback to the employee, or reassignment to a more suitable position. The general thrust of the performance appraisal should be constructive in order to improve performance. Although timely and effective communication may prevent serious problems from developing, occasionally employees may have to be dismissed for poor performance, dishonesty, conflicts of interest, or other reasons.

The appraisal session should be documented in writing for the benefit of supervisors and employees. A formalized appraisal system encourages supervisors to observe employees' performance on an ongoing basis, to emphasize development, and to base decisions on specified standards of performance. Also, the employees' goals for career advancement and an IDP to document planned training and developmental experiences should be prepared. Finally, a performance appraisal cannot be a once-a-year activity; constructive feedback should be continual since the timeliness of appraisals and the degree to which managers follow established procedures influence the effectiveness of a performance appraisal system.

<u>Compensation Administration</u>

Each board must ensure that the institution's compensation administration program is managed in accordance with the requirements of the Act and sound business practices. Generally, sound business practices dictate that the compensation program attract and retain individuals qualified for the responsibilities of each job position, and reward those that meet or exceed performance criteria. Merit pay is also a basic principle of sound business practices. Characteristics of a compensation administration program include:

- A board-approved compensation policy;
- Written job descriptions;
- A system for evaluating jobs;
- Salary ranges based on the competitive market;
- Salaries based on equity and performance; and
- Incentive programs based on improved or sustained performance and the accomplishment of institutional goals and objectives.

Compensation programs should take into consideration job "worth," employee performance and contribution to the institution, the competitive market, and costs. One of the first steps in designing a successful compensation administration program requires the board to adopt a compensation philosophy and policy statement. The board must evaluate and determine the financial benefit and the costs of staffing for each position to ensure that the overall compensation plan is reasonable. Some organizations pay higher than average salaries to attract the best talent; some pay the going rate for similar positions elsewhere; and others pay somewhat below market to keep salary costs down. There is merit to each of these approaches, depending on an institution's needs in terms of quality and workforce retention.

A second element of effective compensation administration is written job descriptions for all employees and a system for evaluating jobs and assigning them to salary ranges. Some institutions utilize consulting firms to evaluate the positions; some use the personnel department or a personnel committee; and others use panels of experts. Any of these approaches may be appropriate in an organization, as long as the selected approach results in internal equity, and differences in grades or compensation levels are linked to differences in position requirements.

The third element for effective compensation administration is the compensation paid to the chief executive officer and selection of appropriate salary ranges for other employees. Section 5.19 of the Farm Credit Act requires FCA to conduct an analysis of the compensation paid to the chief executive officer and the salary scales of bank employees as part of all bank examinations. An organization may have many or few grade levels, wide or narrow salary ranges, and steep or flat progression between the ranges. There are no set rules, but ranges should be assigned to positions on the basis of the job worth.

To determine the "appropriate" salary range for the CEO and other employees, organizations generally use salary surveys to compare their compensation rates to similar positions (benchmark positions) in comparable organizations. Salary surveys may be published on a national, regional, or local basis; however, the geographical base that corresponds to the organization's particular labor market should be used. For example, local surveys typically are appropriate for most nonexempt positions, regional surveys for many specialty and professional occupations, and national surveys for senior executive positions.

Benchmark comparisons allow institutions to ensure the salary scale for each position is competitively priced in accordance with jobs of comparable responsibility and complexity in other institutions with similar size, functions, and operations. Regardless of the comparable used, boards of directors must ensure adjustments to employee salary scales are supported with studies that substantiate the basis for the salary scale approved for each position in the institution. Such studies must demonstrate <u>independence</u> from executive management, and be fully supported by objective data from the competitive <u>marketplace</u>.

An organization should make full use of all salary ranges. Progression in the range should be determined by performance. Salaries paid above the range maximum or below the minimum should be supported by the board and/or senior management. Finally, the program must be kept current and adaptable to changing economic and organizational needs.

The board must also determine if the institution has sufficient earnings capacity to cover both its compensation programs and other costs of operations. In those instances where the institution provides deferred compensation to officers or employees, the financial impact of those programs in future periods should be determined and addressed in the institution's financial planning. Compensation programs may be criticized if they unnecessarily burden the institution's financial performance and condition, or if the institution cannot afford the programs provided.

In addition to the basic salary structure, the board may adopt an incentive compensation program to encourage improved or continued performance and the accomplishment of the institution's strategic goals and objectives. A successful incentive program requires careful construction and monitoring. Since these programs may also increase total compensation expenses, the board should carefully weigh the cost-benefit of such programs

The board should analyze the incentive program prior to implementation and closely monitor its impact on achievement of the institution's business and capital plans. The incentive program should be multi-faceted and linked to the goals and objectives that are critical to the institution's long-term success. It is usually not desirable to design a program that rewards employees for achieving a single goal or objective as this may inappropriately de-emphasize other areas which are important for long-term viability. Further, incentive programs should be easily understood, yet challenging for the participants. If incentive targets are established at levels below those already achieved, the board should document the support for their decisions. In some instances, a lower target may be realistic and commendable. For example, in a declining economic environment, a credit quality goal of 96 percent may be challenging even if the association currently has 98 percent credit quality. The incentive program should also be dynamic in nature to reflect changes in the institution's internal and external environments. The board should also assess the method in which participants shall be assessed, and the financial costs of the program

<u>Employee Benefits</u>

Employee benefits have many characteristics that are unlike those of salary and incentive programs. Benefits provide supplemental support to employees in the form of programs that promote the employee's health and well being. For example, benefits can include:

- Retirement and thrift plans;
- Insurance programs (health, life, and short-term and long-term disability);;
- Leave (annual, sick, and administrative);
- Relocation expenses;
- Executive perquisites (memberships, special subscriptions, and car and/or travel allowance);
- Automobiles;
- Parking;
- Cafeterias (subsidized);
- Physical examinations and fitness programs; and
- Credit unions.

The first necessary element of a successful benefits program is a philosophy and policy statement approved by the board of directors. Each organization should have a policy stating its perceived obligations to employees. For example, the policy should address the employer's obligation concerning life insurance and survivor benefits; sick leave, hospitalization, and long-term disability; vacation; and retirements. When the organization has addressed these issues, an overall benefits program that meets corporate responsibilities can be developed and approved. It is important to look at benefits from a total systems standpoint to ensure conformance with organizational philosophy, ensure programs receive adequate consideration before being implemented, avoid overlap in coverage, and consider the total benefits costs to the organization.

Pension and thrift savings plans often make up a large part of an institution's benefit costs. Pension plans disburse retirement benefits through application of a defined benefit formula. The formula imposes a long-term financial liability that, regardless of institutional profitability, may require significant allocation of funds in order to meet pension commitments. Thrift savings plans are a retirement benefit supplement, which is produced through defined contributions by employees and employers to a savings program. Examiners should ensure pension and thrift plans are based on prudent business decisions and consistent with the institution's competitive market.

Boards of directors should appropriately control the costs of benefit programs and ensure they are affordable to the institution. The costs of benefits can change significantly during a given period as a result of pension reform and legislation, changes in health insurance, additional holidays, rising social security contributions, and increased salaries. As such, it is necessary to analyze the cost of the entire benefits program on a regular basis.

Examination Procedures

The following procedures provide guidance for evaluating HRM. Consistent with risk-based examination principles, examiners should add, delete, or modify the procedures as needed based on the particular circumstances of the institution.

1. Utilize discussions with institution management as needed to gather information for conducting the HRM review.

2. Review all previously reported HRM weaknesses recorded in the workpapers and reports of previous examinations. Determine their current status and identify continuing areas of concern and risk.

3. Review HRM policies and the business plan to determine if HRM policies are consistent with the overall management system and the organization's goals and objectives.

4. Review board minutes to ensure the board receives reports that reflect how consistently HRM policies are adhered to throughout the organization.

5. Review the institution's HRM plan/forecast to determine if it:

    a. Adequately considers the future need for employees brought about by turnover and changes to the organization's mission and function;

    b. Relates to the long-term planning function;

    c. Includes a succession plan for key personnel; and

    d. Effectively uses performance appraisals and employee development to meet future needs.

6. Review the institution's HRM policy with respect to recruiting and employment practices to determine if it:

    a. Identifies job-related qualifications for all positions;

    b. Requires vacancies to be advertised;

    c. Includes a career-planning program to assess employee potential and assure development; and

    d. Considers long-range career planning development, counseling, and other non-salaried employment aspects.

7. Review the institution’s AAP plan and other HRM policies and practices to determine if they comply with federal, state, and local laws and regulations including, but not limited to, civil rights laws, FLSA, and regulations of the EEOC. Review the institution's AAP plan to determine if it includes, at a minimum, the substantive standards set forth in 41 CFR Part 60-2, including: NOTE: The guidance in this procedure is outdated due to changes in the regulations. See Attachment A for a link to the current regulations.

   a. Development or reaffirmation of the institution’s equal employment opportunity policy in all personnel actions (41 CFR 60-2.13(a));

   b. Formal internal and external dissemination of the equal employment opportunity policy (41 CFR 60-2.13(b));

   c. Establishment of responsibilities for implementation of the affirmative action program (41 CFR 60-2.13(c));

   d. Identification of problem areas (deficiencies) by organizational units and job groups (41 CFR 60-2.13(d)). The AAP plan should include an analysis of all major job groups at the institution, with explanation if minorities or women are being underutilized in any one or more job groups (41 CFR 60-2.11(b));

   e. Establishment of goals and objectives by organizational units and job groups, including timetables for completion (41 CFR 60-2.13(e)). The examiner should consider the results that could reasonably be expected from an institution's good faith effort into making its overall affirmative action program work (41 CFR 60-2.12a). Goals should also be measurable, attainable, and reasonable and should consider the anticipated expansion, contraction, and turnover in the workforce (41 CFR 60-2.12(c) and (f)).

   f. Development and execution of action-oriented programs designed to eliminate problems and further designed to attain established goals and objectives (41 CFR 60-2.13(f)). An institution’s affirmative action compliance should not be judged solely by whether it reaches its goals or meets its timeframes. Instead, compliance should be evaluated by reviewing the contents of the program, the extent of adherence to the program, and the institution’s good faith effort to make its program work (41 CFR 60-2.15);

   g. Design and implementation of internal audit and reporting systems to measure the effectiveness of the total program (41 CFR 60-2.13(g));

   h. Compliance of personnel policies and practices with the Sex Discrimination Guidelines set forth in 41 CFR Part 60-20 (41 CFR 60-2.13(h)). For example, written personnel policies state that there shall be no discrimination against employees on account of sex (41 CFR 60-20.3). Further, the employer shall take affirmative action to recruit women to apply for those jobs where they have been previously excluded (41 CFR 60-20.6);

   i. Active support of local and national community action programs and community service programs designed to improve the employment opportunities of minorities and women (41 CFR 60-2.13(i)); and

   j. Consideration of minorities and women, not currently in the work force, having requisite skills who can be recruited through affirmative action measure (41 CFR 60-2.13(j)).

   A copy of 41 CFR Part 60-2 is attached to provide additional guidance to examiners (Attachment A).

8. Review the institution's training and development program to determine if it:

a. Utilizes the human resources plan/forecast to assure development results in the right numbers and skill levels of employees;

b. Prepares employees for activities beyond current job responsibilities;

c. Uses performance evaluations to identify performance deficiencies that may be corrected by training;

d. Requires training to be planned through the use of IDPs; and

e. Requires the results and effectiveness of training be evaluated.

9. Review the institution's performance evaluation program to ensure it:

   a. Is documented in writing, and is timely and objective;

   b. Documents standards, which are related to and consistent with the institution's goals and objectives, for all employees;

   c. Provides for a means to measure performance;

   d. Requires performance discussions between supervisors and employees, at least annually, and that these discussions be documented; and

   e. Is used to determine reasons for weak performance, identifies corrective action, and utilizes IDPs to address weaknesses.

10. Analyze the institution's compensation administration practices to ensure:

   a. The board has adopted a compensation policy that defines compensation for the organization;

   b. Employees have written job descriptions;

   c. CEO compensation and employee salary ranges are based on job "worth" as supported by objective data from the competitive market, i.e. independent and objective salary surveys, and are consistent with the compensation policy (examination coverage is statutorily required for all System banks);

   d. Salary adjustments are related to employee performance;

   e. Salaries are equitable, i.e., comparable pay for comparable jobs;

   f. The compensation program provided to employees is reasonable and affordable by the institution;

   g. CEO and other executive officers' performance standards are consistent with business plan goals and job descriptions, quantifiable to the extent possible, and able to be monitored and measured; and

   h. Annual report disclosures of senior officer compensation were accurately made as required by FCA Regulation 12 CFR § 620.5(i)(2).

11. If the institution has an incentive program, determine that the program is reasonable by considering if:

   a. The program encourages improved performance and the accomplishment of strategic goals and objectives;

b. Funding for the program is obtained from increased revenue produced by the accomplishment of goals and objectives;

c. The program is easy to understand, implement, and administer, and performance measurement is accurate.

d. Rewards are based on multiple goal achievement and these goals are compatible with the business plan;

e. The program rewards a team, department, branch, or the entire institution, not the individual;

f. The program was adequately analyzed prior to adoption and is closely monitored to assess the accomplishment of established goals and objectives; and

g. Any changes in the program are consistent with profitability.

12. Review the institution's employee benefits program to determine if:

a. The board has adopted a comprehensive philosophy or policy statement regarding employee benefits;

b. Individual benefit cost information and the level of benefits for which employees are enrolled is periodically given to employees;

c. The kinds and level of benefits are based on the competitive market and are consistent with the benefit policy of the board;

d. Benefit costs, including leave costs, are regularly analyzed;

e. Benefit costs are compatible with the financial condition of the institution; and

f. Pension and thrift savings plans are adequately funded to ensure benefit commitments will be fulfilled.

13. Determine if retirement and thrift plans comply with mandated legal, regulatory, reporting, and certification requirements as follows:

a. The institution submits an annual valuation of its retirement plan pursuant to sections 103 and 104 of Employee Retirement Income Security Act of 1974 (29 U.S.C. 1023 and 1024) to the General Accounting Office as required by 31 U.S.C. 9503;

b. The institution has obtained a letter from the Internal Revenue Service that its thrift and retirement plans appear to meet the definition of "governmental plan" set forth in section 414(d) of the Internal Revenue Code (26 U.S.C. 414(d)); and

c. The pension and thrift plan accounting and reporting comply with applicable Financial Accounting Standards Board requirements.

14. Coordinate the HRM examination activities with other members of the examination team and the examiner-in-charge (EIC) to determine if evidence of weaknesses was developed in connection with other examination activities. If so, emphasis should be on ensuring sufficient work is completed to conclude on HRM, and to avoid duplication of examination effort.

15. Weigh the results of the HRM examination work and draw tentative conclusions giving

consideration to cause, effect, materiality, and results of other related examination work.

16. Discuss tentative conclusions and examination findings with examiners responsible for the management, finance, and assets evaluations.

17. Discuss items of concern, scope of work performed, and conclusions with the EIC and appropriate institution management. Obtain a response regarding the cause(s) of deficiencies or weaknesses and anticipated corrective actions.

18. Prepare a leadsheet or other summary document to provide workpaper support for work performed and the conclusions reached.

Attachment A

Refer to the following links for the current regulations and a Dept. of Labor sample Affirmative Action program:

- Title 41 CFR Part 60-2 – Affirmative Action Program Regulations
- Department of Labor Sample Affirmative Action Program